BRIEF IN SUPPORT OF PETITION.

The Jurisdiction to Grant the Writ.

The jurisdiction to grant the writ to review the order of the United States Circuit Court of Appeals for the Second Circuit is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 1938, 28 U. S. C. A. Sec. 47).

Opinion Below.

The opinion of the United States Circuit Court of Appeals for the Second Circuit was rendered January 13, 1941, and a rehearing was denied on January 31, 1941. It is not yet published and appears in this record at Pages 46 to 53.

Statement of the Case.

The statement of the case is clearly stated in the opinion of the Second Circuit (R. 47) from which we quote the following:

> "Each of the parties plaintiff was at one time a holder of one or more of a $30,000,000 issue of Five Year 6% Gold Notes of the Van Sweringen Corporation—Hackner in the amount of $1,000; Bowman, $5,000; and Ballinger, $1,500. According to the terms of a Trust Indenture executed by the Corporation and defendant Guaranty Trust Company as trustee, a large amount of assets were retained unencumbered, and certain liquid assets 'segregated' for the protection of the noteholders. The Corporation found itself unable to meet the payments of interest on the notes due November 1, 1931, and as a result a series of transactions was proposed and carried out whereby the noteholders

received 50 per cent of the face value of their claims in cash and 50 per cent in common stock of the Corporation—the cash being supplied from the Corporation's 'segregated assets,' and the stock by defendant J. P. Morgan & Co. Morgan retained $15,000,000 in face value of the notes, and the rest were canceled. The stock so transferred to the noteholders was then worthless, and Morgan and defendant Guaranty Trust Company, which helped promote the plan, knew it to be worthless; nevertheless they prepared false balance sheets of the Corporation and its subsidiaries showing the stock to have a large value, with intent to deceive the noteholders, who were actually deceived into participating in the plan at a loss of 50 per cent of the value of their former claims. The fact of the misrepresentation was not discovered by plaintiffs until the time when suit was brought. The names of all other former noteholders are unknown; but their number exceeds 1,000, and the interests of all are in common and involve a common question of law and fact. The prayer for relief was for an accounting, damages for the losses sustained by all noteholders, and a receiver to pay the costs of administration and distribute the balance of the proceeds to rightful claimants.

"Twenty-two days after the complaint was filed, and before any action by the defendants, defendants were served with an Amendment to Complaint striking the name of C. J. Bowman as party plaintiff and adding as plaintiffs Grace W. York, who was alleged to be still holding notes in the amount of $6,000, and Eunice E. Eastman, who had held notes in the amount of $10,000, but had been induced to part with them on the same terms as had the original plaintiffs. But the court, without accepting the amendment, granted the motion of the Trust Company and of Whitney, one of the Morgan partners, to dismiss the action for want of jurisdiction."

The court reversed the dismissal as to the petitioner Eunice E. Eastman but sustained it as to all other peti-

tioners on the ground that this was a class suit in the "spurious" sense and the plaintiffs who did not have the required jurisdictional amounts could not be joined in the same suit with Eunice E. Eastman and that their remedy was by separate suits in the State Court.

Points Relied on for Reversal.

1. This was a true class suit under Rule 23(a)(1), and the jurisdictional amount was not to be determined by the separate notes but by the value of the property sought to be recovered for the benefit of the entire class, and the court erred in construing this suit as a class suit in the "spurious" sense.

2. Even if this was a "spurious" class suit it was proper to join the plaintiffs who lacked the jurisdictional amounts with Eunice E. Eastman who had the required jurisdictional amount under Rule 23(a)(3), and the Court erred in holding to the contrary.

3. Under no theory of law was it proper for the reviewing court to exclude Grace W. York as a plaintiff as the owner of a claim to the extent of $6,000 on the theory that on the merits of the case her claim may be reduced to $3,000, as the merits of the claim were not involved in the appeal from the dismissal of the complaint on jurisdictional grounds.

ARGUMENT.

I.

Rule 23(a)(3) should be liberally construed as to enable parties lacking the jurisdictional amount to be joined as plaintiffs with one having the jurisdictional amount in order to avoid unnecessary expenses and litigation, and the court erred in not giving such a construction.

Rule 23(a)(3) expressly authorizes the joinder of claims "where the character of the rights sought to be enforced for or against the class is—several, and there is a common question of law or fact affecting the several rights and a common relief is sought." The opinion in the instant case in reversing the trial court for its narrow construction of the new Federal Rules recognized the liberality of the new rules and construed them "in the light of the wide and flexible content given to the concept of action under the new rules." The new rules must be liberally construed (*Jones* v. *St. Paul Fire Co.*, 108 F. (2) 123) and their entire spirit was designed so that controversies will be decided on merits *without unnecessary delay or expenses.* (*Moore* v. *Ill. R. R. Co.*, 24 F. Supp. 731.)

Assuming for the sake of argument that this was a class suit in the "spurious" sense as decided by the court, the joinder was proper under Rule 23(a)(3) which was designed for such purpose. Even prior to the adoption of these rules the courts have held that it is proper to join claimants who lacked the jurisdictional amount with a claimant who had the required amount when there was a common state of facts or point of law involved. This was squarely held in *General*

Finance Corporation v. *Keystone Credit Corporation,* 4 Cir., 50 F. (2) 872. There, it was said:

> "As we have seen, the claims of a number of complainants are far in excess of the jurisdictional amount, and *the only question is whether those complainants whose claims are less than such amount shall be allowed to join* in the suit for the purpose of recovering and sharing in the fund in controversy and protecting the assets in which all of the defaulted stockholders have an interest. *It is well settled that this question must be answered in the affirmative.*"

In construing the new rules in *Jones* v. *St. Paul Fire Co.,* 5 Cir., 108 F. (2) 123, the court said (p. 125):

> "The new rules seek to require in a civil action that has also been aimed at in equity suits, that all claims growing out of a single transaction be brought in and settled in one case. Rules 13, 15(c), 18(a). That one of them alone *may involve less* than $3,000.00 *is not an obstacle if the controversy as a whole involves that much.*"

Cases Cited Are Distinguishable:

This opinion cited four decisions (R. 50) by this court on the point that it is improper to join a creditor lacking the jurisdictional amount with a creditor having the jurisdictional amount in a "spurious" suit. *The first three cases deal with questions of appeal* by the creditors having less than the jurisdictional amount, and this court properly held that *while it was proper to join the creditors lacking the jurisdictional amount with those having the jurisdictional amount*—as a matter of practice, *they had no right to appeal after their claims culminated into decrees* which separated the claims and the jurisdictional amount was then governed by the amount of the decree. In each of the cases *the right to join* for the purpose of convenience and to save expenses *was*

recognized but *the right to appeal was denied.* In the *Rich* case (12 How. 347) the court expressly recognized this distinction and pointed out that *the question of joinder was not a question of jurisdiction* but of "practice of the court for its convenience" while *the right of appeal was jurisdictional* and approved the propriety of the joinder. The *Stewart* case (115 U. S. 61) made the same distinction. The same is true of the *Gibson* case (122 U. S. 27). The *only* case which *on its surface* seems to support the view of the court is the *Clark* case (306 U. S. 590). However, even this case *did not decide the matter on jurisdictional grounds* but *on the ground of better practice.* It relied in its decision on the authorities above discussed which applied to *jurisdiction on appeal* and it failed to notice the distinction. This distinction was also clearly pointed out in *Starwood* v. *Wishard,* 134 F. 359, 961.

Whatever the practice may have been when the *Clark* case was decided, *it is now completely changed by Rule* 23(a)(3). While it may be true that even under that rule the several claims may not be aggregated to make up the jurisdictional amount, yet where *one claim has the jurisdictional amount* and the question involves common questions of law or fact, *the right of joinder exists. There is no longer a question of jurisdiction in such joinder but a question of convenience and practice* and under the liberal construction of the new rules *as conceded by this opinion* these noteholders who predicate their claims on common questions of law and fact should not be compelled to litigate their suits individually and incur the additional expense. Incidentally, even the *Clark* case, in a marginal note, cited a case of a creditor's suit which comes within the "spurious" class where creditors having less than the jurisdictional amount may be joined for the purpose of participating in any fund to be distributed. In the instant case the

plaintiffs are seeking an accounting for the assets wrongfully acquired by Morgan and they are seeking *joint relief against the Mortgage Trustee* and *all* of the noteholders are *jointly* interested in that subject matter.

II.

All of the notes were secured by one trust deed. The action was by the noteholders as a class against the trustee for malfeasance and misfeasance which resulted in a loss common to all. The proceedings were therefore properly invoked under Rule 23(a)(1) and the court clearly erred in construing this suit as under class 23(a)(3).

In order to determine whether this suit was in the nature of a true class suit under 23(a)(1) or whether it was of the "spurious" class under 23(a)(3) it is necessary to consider the nature of the complaint and the relief sought. We will therefore briefly restate the subject matter of the complaint.

The original complaint, which was confessed to be true, alleged that plaintiffs are original purchasers of the gold notes of an issue of $30,000,000 executed by Van Sweringen Corporation and marketed by the defendants, Guaranty Trust Company (the Trustee) and "Morgan" (the Bankers). The Trust Indenture prohibited the mortgagor from marketing or pledging any of its assets if the value of all readily marketable securities free from mortgage shall be less than 50% of the principal amount of its then unsecured funded debt. The mortgagor was to maintain "segregated assets" to the extent of 50% of the amount outstanding on the $30,000,000 note issue. Its principal officers guaranteed to maintain the "segregated assets" in *liquid* condition, and in the event of a decline in the market they were to supply additional securities designated as

"assigned securities." (R. 4.) At the date of the alleged conspiracy the mortgagor held in its possession $3,766,000 of the gold notes, and there was then outstanding in the hands of the public $26,234,000 of the gold notes. There were "segregated assets" and "assigned assets" in cash and government current market value obligations in the sum of $13,440,681.86.

The mortgagor had no funds to meet the interest maturity on the gold notes due November 1, 1931 (approximately $800,000). The trustee had the right to accelerate the bond issue at the election of the required number of noteholders. Upon such acceleration the noteholders would have received the $13,440,681.86 from the "segregated assets" and "assigned securities." The noteholders would have also obtained a deficiency for the balance and could have applied all assets of the mortgagor towards such deficiency. To prevent such result and to maintain the note issue in good standing the defendants (who marketed the securities) entered into an agreement to offer to the noteholders to pay them 50% cash, and for the balance of the 50% to give them in exchange the common stock of the mortgagor. Under such exchange the defendants were able to obtain the funds from the "segregated assets" and "assigned securities," to pay the 50% in cash and thereby wipe out the noteholders as creditors, and to appropriate all of the corporation's property to themselves. The details how the deal was accomplished were set forth in the complaint. As a result of the foregoing conspiracy the defendant "Morgan," with the aid of the Guaranty Trust Company (the Trustee), exchanged the worthless common stock which was then hold by "Morgan" as collateral, for the gold notes, and used the "segregated assets" to pay the cash on the gold notes and thereby acquired the remainder of these assets, as well as assets of the corporation. The net result was to relegate the position of the

noteholders to that of the holders of worthless stock and to give to the defendant Morgan the available cash, the $15,000,000 gold notes and the remainder of the assets as the only remaining substantial creditor of the company (R. 4-8).

The amendment to the complaint eliminated one of the plaintiffs and added two plaintiffs, Grace W. York, as an owner of $6,000 of the notes, and Eunice E. Eastman, as an owner of $10,000 of the notes. As to Grace W. York, it was alleged (Abst. 36) that she was an owner of $6,000 of said notes, whose notes were never exchanged for the worthless stock, *but she did not receive anything in payment of principal and interest since November 1, 1931.** The relief as prayed in the complaint was (*a*) for an accounting against the Guaranty Trust Company of New York, as Trustee, and against Morgan "for all funds and property received by them as a result of the exchange of the gold notes for the common stock." It asked (*b*) in the alternative, that they be held jointly and severally liable for the damage caused to the noteholders; (*c*) that the court may find and determine that the Guaranty Trust Company of New York, as Trustee for the $30,000,000 note issue, breached its fiduciary duties to protect the rights of the noteholders and because of its malfeasance and misfeasance is liable to the noteholders for the damage caused to them by reason of the exchange of the notes for the worthless stock. It is true that under (*d*) the plaintiff asked for the appointment of a receiver, but this relief was sought only *after the entry of a final decree for the purpose of administering the funds for distribution* (R. 9).

* She was even defrauded of the 50% cash out of the "assigned securities" which were taken away by "Morgan" with the aid of the Trustee.

(a) A suit by noteholders against a Trustee of the note issue for misfeasance and malfeasance common to all noteholders is a suit within Rule 23(a)(1), and the Court erred in classifying this suit as a spurious class suit.

From the statement of facts as above shown it appears that this was a suit by beneficiaries of a trust against their trustee for loss sustained by the beneficiaries in which they were commonly interested. Such a suit is a true class suit. *Notes secured by one instrument may be totalled for the jurisdictional amount.* (*First State Bank* v. *Chicago, et al.*, 63 F. (2) 585, 587; *Fitchett, et al.* v. *Blows*, 74 F. 47, C. C. A. 8.) It is true that as to the relief against Morgan it may be considered in a "spurious" sense, but the complaint having stated at least *one cause which properly invoked the jurisdiction*, it was improper to dismiss it *no matter how improper the other causes might have been.* (*Commercial National Bank of Los Angeles* v. *Catron*, 50 F. (2) 1023.)

(b) The decision in the instant case that no class suit may be maintained by several noteholders predicated on fraud on the theory that the fraud might have been separate to each noteholder when the contrary was alleged and confessed to be true by the motion to dismiss, is in conflict with the decisions of the Seventh and Third Circuits and with the latest decision of this court.

The opinion stated:

"The claim here stated is for misrepresentation, whereby the plaintiffs were induced to make a sale of their notes for less than their true value. Clearly,

each plaintiff, to prevail, must show that he himself was misled by defendants' misrepresentations, and that as a result he sustained a loss."

The complaint alleged a common plan to defraud all noteholders by a secret agreement between the defendants (R. 5, Par. 8). It alleged the making of the written agreement which was concealed from the investors to the date shortly prior to the filing of the complaint (R. 5). It alleged that as a result of said conspiracy the noteholders were relegated to the position of the holders of worthless stock and Morgan acquired the corporate assets (R. 6). It alleged that for the purpose of deceiving the noteholders they prepared a false balance sheet which they published (R. 6, 7). It stated that if the real information had been disclosed "the plaintiffs and the other noteholders would have received in excess of $13,000,000 to apply on approximately $26,000,000 of gold notes" out of the cash and in addition thereto "they would have participated in all of the assets of the company to satisfy the deficiency for the other half that would be due them." It alleged that "because of the concealment of the facts they were induced to exchange their notes for the worthless stock" and the defendants appropriated to themselves "all available assets" to the damage of "the noteholders."

Paragraph 13 of this complaint alleged (R. 7):

> "The names and addresses of the other noteholders are unknown to them, and they exceed 1,000 in number. It would also be impractical to bring them all before the court as parties, and the interests of the noteholders who exchanged their notes for the stock are common with the interests of the plaintiffs *who have all exchanged their stock by the written communication contained in the offer, and the secret agreement was concealed from all of them.* That there is a *common question of law and*

> *fact affecting the rights of all such noteholders,* and plaintiffs therefore bring this action in their own right and for the common use and benefit of all other such noteholders who are similarly situated and for their common use and benefit."

These allegations were *not open to contradiction by the motion to dismiss.* The Seventh Circuit squarely held to the contrary. (*Railway Exchange Agency* v. *Jones,* 106 F. (2) 341.) There it was said (p. 343):

> "While defendant's contention that a class suit may not be maintained where each claimant of the class asserts a separate claim based on individual and *separate fraudulent representations,* is sound, we are bound, at this stage of the proceedings, by the allegations of the complaint. *It is possible, accepting the allegations of the complaint, that there exists a case of joint action upon identical fraud with the resulting total damage exceeding $3,000.* It is only after proof had been received on this issue, or admissions made in open court by plaintiff, that the court may, in view of the pleadings, deny plaintiff's right to sue at all; that is, to maintain a class suit."

We cited to the Second Circuit this decision (R. 61), as well as the decision of the Third Circuit in *Independence Shares Corporation* v. *Deckert,* 108 F. (2) 51, which squarely passed on this question and *coincided with the opinion of the Seventh Circuit.* At that time this case was pending on a writ of certiorari before this court. Since the rendition of the opinion in the instant case *this court has ruled and sustained the decision on this point.* (*Deckert* v. *Independence Shares Corporation,* 85 Law ed. P. 171.) We quote the following from the opinion of this court:

> "The bill alleges that Independence and its predecessor Capital were guilty of fraudulent misrepresentations and concealments in their sale and advertisement of contract certificates to petitioners and

> others similarly situated in violation of the Securities Act of 1933. * * *
>
> "None of the original petitioners' claims exceeds $3,000 and respondents contend that the aggregate of all of them will not exceed $3,000. It is conceded that the assets sought to be reached are greatly in excess of $3,000. * * *
>
> "Respondents' motions sought to dismiss the bill because it failed to state any cause of action and because the District Court lacked jurisdiction. We hold that these motions were correctly denied."

In Hughes Federal Practice (Vol. 18, p. 78) the author says that this case is *typical* of the cases under 23(a)(3). (See notes 22-24.)

The decision of the Second Circuit cannot be harmonized with the decision of the other circuits and with the latest decision of this court, and this deserves the issuance of the writ.

III.

The court clearly erred in excluding Grace W. York as a plaintiff on the ground that the merits of the case may show that her $6,000 claim will be reduced to $3,000.

The opinion of the court which concluded that Eunice E. Eastman is the only plaintiff having the jurisdictional amount and that Grace W. York, an owner of $6,000 in notes, lacks the required jurisdictional amount is founded on a misconception due to the fact that the court considered that her cause of action was for 50% of her claim. Her claim is not for the loss of 50% *but for the entire loss of her $6,000 evidenced by the notes which are now worthless.* On the appeal the court could only consider the allegations of the complaint as *its sufficiency was not challenged.* According to the complaint

as amended York *did not receive the 50% out of the "assigned securities"* and "secured assets" and the defendant Morgan acquired *all* of the valuable corporate assets, leaving her notes *worthless*. She therefore stands to lose not $3,000 *but $6,000*. If it were not for the fraudulent deal whereby the "assigned securities" and "secured assets" were appropriated by the defendants to carry out their scheme, Grace W. York would have had available 50% cash out of these assets and for the balance of her claim she would have had all other corporate valuable assets which she was now deprived of.

The complaint alleged that the "assigned securities" and "secured assets" which were available to pay 50% in cash were acquired by the defendant Morgan (R. 6) and that said defendant *"appropriated the remainder of the valuable assets of the company, as its largest creditor."* It stated that "the net result" was "to give to the defendant (Morgan) the available cash, the $15,000,000 in gold notes, and *the remainder of the assets* for the exchange of the worthles stock" so that Morgan acquired all of the remaining corporate assets. The complaint charged that this was done (R. 5) "to *prevent the acceleration* of the gold notes" and to obtain the application of the "segregated assets" and "assigned securities" and *the application of the other property of the company"* to the payment of any *"deficiency."* It alleged (R. 7) that if the real information had been disclosed the plaintiffs would have received their 50% in cash *"and in addition thereto they would have participated in all of the assets of the company to satisfy the deficiency for the other half that would be due them,* but because of the concealment of the facts" the defendants have obtained these advantages "and all available assets of the company and its subsidiary, to the damage and the detriment of the noteholders." *The claim of York, who did not receive even the 50% in cash,*

is therefore for the total loss of her $6,000 and not for 50% thereof, as the court clearly held in excluding her as a party.

For the reasons above stated we urge an allowance of the writ.

Respectfully submitted,

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